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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 200

STATE OF NEW YORK, *Petitioner,*

vs.

LEONARD H. CARTER, as Trustee in Bankruptcy.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE STATE OF NEW YORK, PETITIONER

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INDEX.

Subject:	Page
1. Opinions Below	1
2. Jurisdiction	1
3. Question Presented	2
4. Statutes Involved	2
5. Statement	2
6. Specification of Errors to be Urged	4
The court erred:	
(1) In holding that interest on tax claims of the State of New York should be allowed only to the date of the filing of the petition in bankruptcy; and	
(2) In affirming the order of the District Court.	
7. Summary of Argument	4
I. The State of New York is entitled to interest on its claims for franchise and unemployment insurance taxes to the date of payment of the claims. The amendments to §§ 57 (j), 57 (n) and 64 (a) of the Bankruptcy Act, as contained in the Chandler Act did not change the previously existing rule that tax claims carry interest to the date of payment.	
II. Evidence that the trustee in bankruptcy was engaged in litigation over a period of years, which resulted in an increase in the value of the assets of the bankrupt estate, is immaterial to the question whether interest on tax claims is payable to the date of payment of the claims. The question presented is one of law and not of equity.	
8. Argument	5

PAGE

I. THE AMENDMENTS TO THE BANKRUPTCY ACT BY THE CHANDLER ACT IN 1938 DID NOT CHANGE THE PREVIOUSLY EXISTING RULE THAT TAX CLAIMS AGAINST A BANKRUPT ESTATE CARRY INTEREST TO THE DATE OF PAYMENT 5

II. THE QUESTION PRESENTED IS ONE OF LAW AND NOT OF EQUITY 11

9. Conclusion 13

10. APPENDIX 14

CITATIONS.

Cases:

Beardsley & Wolcott Mfg. Co., Matter of, 82 F. (2d) 239 ..... 5, 7

Davie v. Green, 133 F. (2d) 451 ..... 3, 7

Dayton Trustee, v. Stanard, Treasurer, etc., 241 U. S. 588 5

Horne v. Boone County, Neb., 44 F. (2d) 920 ..... 5, 7

Martin, Matter of, 75 F. (2d) 618 ..... 5, 7

Meilink v. Unemployment Reserves Commission of Cal., 314 U. S. 564 11

New Jersey v. Anderson, 203 U. S. 483 12

People, etc. v. Jersawit, Trustee, 263 U. S. 493 5

Pepper v. Litton, 308 U. S. 295 12

Saper v. City of New York, 168 F. (2d) 268 ..... 3, 5, 6

Semon, Matter of, 80 F. (2d) 81 7

Standard Composition Co., Matter of, 23 F. Supp. 391 7

State of New York v. Carter, 168 F. (2d) 272 1

Summers Co., D. O., The, Matter of, 45 A.B.R. (N.S) 123 7

United States v. Childs, 266 U. S. 304 5

STATUTES.

	PAGE
United States	
Bankruptcy Act	
Section 37j (11 U.S.C.A. 93j)	4, 5, 6, 8, 10
Section 57n (11 U.S.C.A. 93n)	4, 6, 7
Section 64a (11 U.S.C.A. 104a)	4, 6, 7
Section 64b (11 U.S.C.A. 104b)	6, 7
Judicial Code (28 U.S.C.A. 347)	
Section 240 (a)	1
New York State	
Unemployment Insurance Law (Article 18, Labor Law, Chapter 31 of the Consolidated Laws of New York)	1, 2, 4
Section 570, subd. 1, 2, 3, 4	10
Tax Law (Chapter 60 of the Consolidated Laws of New York)	2
Article 9A	2
Section 213	10

MISCELLANEOUS.

Chandler Act, (June 22, 1938, c. 575, 52 Stat. 840)	5, 7, 8
Collier on Bankruptcy	8
House Report No. 2083 (House Reports, 80th Congress, Second Session)	9
H. R. 5693 (80th Congress, Second Session)	8

Question Presented

The question presented here is whether the claims of the State of New York for corporate franchise taxes and unemployment insurance taxes against the estate of the bankrupt are entitled to carry interest to the date of the payment of the claims or to the date of the filing of the petition in bankruptcy only.

Statutes Involved

The pertinent statutes are set forth in the appendix, *infra*, pp. 14-17.

Statement

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939 (R. 4). The State of New York filed a tax claim for corporation franchise taxes under Article 9-A of the Tax Law of the State of New York for the years 1936, 1937 and 1938, in the sum of $1,403.14, and for unemployment insurance taxes covering the period January 1, 1936 to October 28, 1939, in the sum of $257.78 (R. 18). These claims asked for interest to the date of payment of the same (R. 6). By notices dated July 1 and July 2, 1946, the trustee in bankruptcy filed objections to the demand for interest on these claims beyond the date of the filing of the petition in bankruptcy (R. 3). After consolidated hearings, the referee in bankruptcy, on January 24, 1947, filed separate findings of fact and conclusions of law, and on the same date filed a consolidated memorandum overruling the trustee's objections to the allowance of interest to the date of payment, and entered orders to that effect (R. 19-21). Thereafter, the referee reopened the proceeding for the purpose of hear-

ing a further objection of the trustee based upon certain alleged equitable considerations, but sustained the objections to this evidence and made an order to that effect (R. 22-27). Upon the petition for review, the District Court reversed the order of the referee allowing interest on the tax claims to the date of payment and sustaining objections to the trustee's offer of proof at the hearing (R. 11-17). The District Court held that interest on tax claims of the State of New York should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition (R. 13-17). The District Court also held that the evidence presented with respect to the cause of the long delay in the administration of the estate, if pertinent to the determination, was sufficiently shown by the records of the court to supplement other reasons for the denial of the interest (R. 17).

The court below affirmed the order of the District Court upon the authority of *Saper* v. *City of New York*, 168 F. (2d) 268, decided on the same day the instant case was decided.

Two of the three judges who sat in the instant case did not agree with the three judges who sat in the *Saper* case, nor with the decision of the District Court. They felt bound, however, to follow the decision of the court on this question in the *Saper* case. The two judges in the Circuit Court, who were of the opinion that the State's tax claims are entitled to interest to the date of payment, expressed their personal views on the subject in their opinion. These views are in accord with those of the First Circuit in *Davis* v. *Green*, 133 F. (2d) 451 (R. 28-31).

Specification of Errors to be Urged

The court below erred:

(1) In holding that interest on tax claims of the State of New York should be allowed only to the date of the filing of the petition in bankruptcy; and

(2) In affirming the order of the District Court.

Summary of Argument

The argument that follows may be briefly summarized:

I.

The State of New York is entitled to interest on its claims for franchise and unemployment insurance taxes to the date of payment of the claims. The amendments to §§ 57 (j), 57 (n) and 64 (a) of the Bankruptcy Act, as contained in the Chandler Act did not change the previously existing rule that tax claims carry interest to the date of payment.

II.

Evidence that the trustee in bankruptcy was engaged in litigation over a period of years, which resulted in an increase in the value of the assets of the bankrupt estate, is immaterial to the question whether interest on tax claims is payable to the date of payment of the claims. The question presented is one of law and not of equity.

ARGUMENT

I

The amendments to the Bankruptcy Act by the Chandler Act in 1938 did not change the previously existing rule that tax claims against a bankrupt estate carry interest to the date of payment.

It cannot be disputed that, prior to the amendment of the Bankruptcy Act by the Chandler Act, tax claims carried interest to the date of payment.

Dayton, Trustee v. *Stanard, Treasurer, etc.* (1916), 241 U. S. 588;

People of the State of New York v. *Jersawit, Trustee* (1924), 263 U. S. 493;

United States v. *Childs* (1924), 266 U. S. 304;

Horn v. *Boone County, Nebraska*, (1930, C. C. A. 8), 44 Fed. (2d) 920;

Matter of Beardsley & Wolcott Mfg. Co. (1936, C. C. A. 2), 82 Fed. (2d) 239; and

Matter of Martin (1935), C. C. A. 7), 75 Fed. (2d) 618.

In the foregoing cases, interest on tax claims to the date of payment was allowed under the authority of § 57 (j) of the Bankruptcy Act. That section has remained unchanged since the original Bankruptcy Act was passed in 1898, except that the words "state, county, district or municipality" were taken out and the words "or any state or subdivision thereof" inserted in their stead by the Chandler Act. This change, of course, is immaterial to the question presented here.

The members of the court below, who heard the case of *Saper, etc.* v. *The City of New York*, 168 F. (2d) 268, de-

cided on the same day the instant case was decided, and which constituted the authority for the decision in the instant case, felt that the reason for the rule providing for interest to the date of payment was that the original bankruptcy act treated tax claims quite differently from other debts, that § 64 (a) [11 U.S.C.A. § 104 (a)] ordered the trustee to pay all taxes legally due and owing by the bankrupt to the United States, state, county, district or municipality in advance of the payment of dividends to creditors, and that the trustee was compelled to search out the tax creditors and pay their claims. The court, in the *Saper* case, concluded, further, that by the amendment to § 64 (a) in 1926 (c. 406, § 15, 44 Stat. 666), which added the words "in the order of priority as set forth in paragraph (b)," and which placed tax claims next to last, and by the amendment to §64 (b), which spoke of the "debts to have priority" in advance of the payment of dividends to creditors "and to be paid in full out of bankrupt estates," in the order then stated, Congress evinced an intention to remove tax claims from the priority theretofore accorded them. The court felt that even if these changes were not sufficient to alter the previously existing rule with reference to the payment of interest, the amendments to § 64 (a) [11 U.S.C.A. § 104, sub. a] and § 57 (n) [11 U.S.C.A. § 93, sub. n] by the Chandler Act, wherein § 57 (n) was broadened to include all claims of the United States and of any State or subdivision thereof, and required them to be proved and filed in the manner provided by that section, certainly accomplished that result. The court felt that the Bankruptcy Act, as it now stands, treats tax claims as debts and the sovereign as a creditor which must make proof of its claim the same as other creditors, and that this took from tax claims their former favored position.

We cannot agree with the court's reasoning that the amendments referred to in any way changed the existing rule. These amendments were for the purpose of facilitating the prompt and orderly administration of bankrupt estates, as noted by Judge Augustus N. Hand in the instant case below (R. 31). It is not apparent from the Chandler Act amendments to § 64 (a) [11 U.S.C.A. § 104 (a)] and 57 (n) [11 U.S.C.A. § 93 (n)], or from the Congressional Reports or debates on the Chandler Act amendments, that Congress ever intended to change the long established rule for payment of interest on tax claims. We believe that the reasoning of the Circuit Court of Appeals for the First Circuit in *Davis* v. *Green*, 133 F. (2d) 451, is sound, and that Congress would not have made such a far-reaching change as would result in reversing the prior interpretation without clear and specific language to that effect. In fact, after the amendments of 1926 and before the enactment of the Chandler Act in 1938, the courts had consistently adhered to the long established rule.

Horn v. *Boone County Neb.* (1930, C.C.A. 8), 44 F. (2d) 920;
Matter of Semon, (1935, C.C.A. 2), 80 F. (2d) 81;
Matter of Martin, (1935, C.C.A. 7), 75 F. (2d) 618;
Matter of Beardsley & Wolcott Mfg. Co., (1936, C.C.A. 2), 82 F. (2d) 239; and
Matter of Standard Composition Co., (1938, D.C. E.D. Mich.), 23 F. Supp. 391.

As bearing on the question whether Congress intended by the Chandler Act to change the rule, we refer to the decision of Referee Friebolin in *Matter of D. O. Summers Co., Bankrupt*, 45 Am. B.R. [N.S.] 123, decided in 1939, wherein he held that tax claims carry interest to the date of payment after the enactment of the Chandler Act. In that case the referee stated (p. 129):

> "Until some decision is rendered directly upon this point by the Supreme Court or a Court whose decision is binding upon me, I am constrained to conclude that interest upon taxes should be allowed to date of payment."

We consider this statement of Referee Friebolin to be highly significant in view of the fact that he was one of the principal draftsmen of the Chandler Act (Collier on Bankruptcy, 14th Ed., Vol. 3, 1946 Cum. Supp., Note 28a, pp. 1843 and 1844). This decision constitutes very strong evidence that Congress did not intend to change the existing rule by any amendment contained in the Chandler Act. If such a change had been intended by Congress, Referee Friebolin would have known about it.

But we think the best evidence of the fact that Congress, by the amendments of 1926 and the Chandler Act amendments of 1938, did not intend any change in the existing rule regarding the payment of interest on tax claims, is the fact that on June 8, 1948, the House of Representatives passed a bill, introduced by Congressman Reed (H. R. 5693, 80th Congress, 2d Session), by which it was intended to amend the Bankruptcy Act in several respects. Section 11 of the bill provided for the amendment of § 57 (j) of the Bankruptcy Act to read as follows:

> "Sec. 11. (a) Subdivision j of section 57 of such Act, as amended, is amended to read as follows:
>
> "'j. (1) Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss up to the date of bankruptcy.
>
> "'(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy

on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed.'"

The bill was referred to the Senate Committee on the Judiciary on June 9, 1948, but no action thereon had been taken up to the time of the adjournment of Congress on June 20, 1948. The report of the House Committee on the Judiciary, which recommended the amendment, clearly indicates its understanding that prior to its introduction no previous amendments to the Bankruptcy Act had changed the rule that tax claims carry interest to the date of payment. This report (No. 2083) states as follows (p. 5):

"Section 11 (a) of the bill is intended both to clarify and modify section 57j of the act. The change in 57j (c) is to make clear that the limitation on interest 'up to the date of bankruptcy' relates only to interest on the 'pecuniary loss,' and further that such interest stops at the date of bankruptcy. The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. (Sec. 63a; *Adams* v. *Napa Cantina Wineries* (C. C. A., 9th Cir.), 36 Am. B. R. (N. S.) 8; *In re Gandolfi & Co., Inc.* (S. D., N. Y.), 51 Am. B. R. (N. S.) 521 (governmental debts and other debts entitled to priority); *3 Collier on Bankruptcy*, 14th Ed., 1835 *et seq.*; *2 Remington on Bankruptcy*, 4th Ed., secs. 771, 795.) However, interest on delinquent tax debts is allowable to the date of payment (*In re Kallak* (D. C., N. D., 1906), 17 Am. B. R. 414; *In re Ashland Emery and Corundum Co.* (D. C., Mass., 1916), 36 Am. B. R. 194; *In re Clark Realty Co.* (C. C. A., 7th Cir., 1918), 42 Am. B. R. 403; *sub silentio, United States* v. *Childs*, 266 U. S. 304, 307 (1924), 5 Am. B. R. (N. S.) 5). Although, under the Chandler Act, a tax debt is required to be proved (sec. 57n) and its order of priority ranks below all administration costs and

expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (sec. 64a (1), (2), (3)), thereby rendering obsolete the reasoning in the *Kallak* case, nevertheless its rule has not been changed, and therefore requires this statutory modification. For further discussion see *In re D. O. Summers* (Ref., N. D., Ohio, 1939), 46 Am. B. R. (N. S.) 123; *In re Dorsey* (Ref., W. D., Wash., 1940), 46 Am. B. R. (N. S.) 146; *Davis* v. *Green* (C. C. A., 1st Cir., 1943), 52 Am. B. R. (N. S.) 603. And on overruling the *Kallak* case see *In re Union Fabrics, Inc.*, (S. D., N. Y., 1947), 73 F. Supp. 685, appeal pending."

This report refers to the decision of the District Court in the instant case. Even in the face of that decision, Congress felt obligated to amend the statute so as to "clarify and modify section 57j of the act." The "clarification" was to make clear that the limitation on interest up to the date of bankruptcy relates only to interest on the "pecuniary loss" and that such interest stops at the date of bankruptcy. The "modification" was for the purpose of changing the rule with respect to the payment of interest on tax claims so that such interest would be payable to the date of the filing of the petition only. In order for this rule to be changed, the Bankruptcy Act "requires this statutory modification."

The officers of the State of New York who administer the Tax Law with respect to corporation franchise taxes and the Unemployment Insurance Law are required to seek collection of delinquencies established by the Legislature of the State of New York. The Legislature, acting within its constitutional sphere, has measured the amount of the delinquency in such cases (Tax Law § 213, Unemployment Insurance Law § 570, subds. 1, 2, 3 and 4, *infra*). Bankruptcy Act § 57 (j) provides for the payment of "such interest as may have accrued thereon according to law." Interest to

the date of payment has accrued on these claims according to the law of the State of New York (*Meilink* v. *Unemployment Reserves Commission of Cal.*, 314 U. S. 564).

H

The question presented is one of law and not of equity.

The District Court, in reversing the order of the referee herein, held that the referee should have considered the equities presented by the record in determining whether interest should be allowed to the date of payment (R. 17), and that "the allowance of interest to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable, and to result in an unbalance of equities between the several creditors rather than 'a balance of equities' which the Supreme Court says is the touchstone of each decision" (R. 17).

There is no question here that the State's claims were filed timely, nor is there any assertion that any action or inaction on the part of the State caused a delay in the payment of claims. The claims were filed in 1940. The assets of the estate, prior to the receipt of the sum of $30,000 in settlement of the claim of the trustee against the bankrupt's former president, were $19,888.11 in cash and a small amount of merchandise (R. 6). This was more than sufficient to pay the entire priority claims of the United States and the State of New York in the principal sum of $14,526.27 (R. 5, 6), with interest which had accrued to the time of the filing of the claims, amounting to $1,233.59, as well as the amount which was paid to the City of New York in compromise of its tax claim in the sum of $3,564.70.

amounting in all to the sum of $16,324.56. After the payment of these tax claims, there would have still remained in the estate the sum of $3,563.55. The trustee, however, chose to let these tax claims remain unpaid until the litigation, which lasted approximately six years, was concluded (R. 4-7). Under these circumstances, there is nothing in this case to charge the State with the delay in payment of its claims and thus justify the court in denying interest on asserted equitable grounds.

In *Pepper* v. *Litton*, 308 U. S. 295, this Court held that bankruptcy courts have certain equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. "They [these equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done" (p. 304). The instant case, so far as the tax claims are concerned, does not fall within any of these categories to which bankruptcy courts may apply equitable powers. Courts may not invoke a balance of equities when such action would be clearly contrary to the statutory mandate (*New Jersey* v. *Anderson*, 203 U. S. 483, 490).

Conclusion

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be reversed.

Dated: Albany, New York, November 17, 1948.

Respectfully submitted,

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APPENDIX

Bankruptcy Act of 1898, c. 541, 30 Stat. 544:

Sec. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * *

j. [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]: Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

n. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 13; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1] Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however*, That the court, may upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *.

(11 U. S. C. A., § 93.)

Sec. 64. DEBTS WHICH HAVE PRIORITY. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1; Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs, and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors

in involuntary cases; where property of the bankrupt transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [*sic*] entitled to priority, and rent owing to a land

lord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

(11 U. S. C. A., § 104.)

New York Tax Law § 213:

* * * If any part of any tax imposed by this article is not paid when due, the taxpayer shall pay to the tax commission, in addition to the amount of such tax, five per centum of such unpaid amount, plus one per centum for each month the tax remains unpaid. The tax commission in its discretion may modify the penalties or additional amounts provided in this article without regard to whether such penalties or additional amounts have been included in a statement of account or an application for revision of such account has been filed.

New York State Unemployment Insurance Law (Labor Law, Article 18)—§ 570, subds. 1, 2, 3 and 4:

Payment of Contributions. 1. Rate. Each employer liable under this article shall pay regularly contributions in an amount equal to two and seven-tenths per centum of his payroll.

2. Time and method of payment. Contributions shall become payable by any employer for wages paid on and after the date on which he becomes liable under this article. All contributions from employers shall be paid at such times and in such manner as the commissioner may prescribe.

3. Default before July first, nineteen hundred forty-seven. If an employer shall default in any payments required to be made by him to the fund before July first, nineteen hundred forty-seven, interest upon the amount determined to be due from the employer shall be payable upon notice and demand from the commissioner at the rate of six per centum per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund.

If any part of any deficiency in payment of the employer's contribution to the fund before July first, nineteen hundred forty-seven is due to negligence but without intent to defraud five per centum of the total amount of the deficiency, in addition to such deficiency, shall be assessed, collected, and paid in the same manner as if it were a deficiency.

4. Default on and after the July first, nineteen hundred forty-seven. An employer who fails to pay contributions required to be made by him to the fund on or after July first, nineteen hundred forty-seven, shall pay interest at the rate of three-fourths of one per centum of the amount of such contributions for each month, or fraction thereof, he is in default. Such interest shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund.